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McKESSON CORPORATION

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

McKESSON CORPORATION, a Delaware
corporation,

Plaintiff,

v.

FAMILYMEDS GROUP, INC.,
f/k/a Drugmax, Inc., a Connecticut corporation,

Defendant.

FAMILYMEDS GROUP, INC.,
f/k/a Drugmax, Inc., a Connecticut corporation,

Counterclaimant,

v.

McKESSON CORPORATION, a Delaware
corporation,

Counterdefendant.

FAMILYMEDS, INC.,
a Connecticut corporation,

Cross-Complainant,

v.

McKESSON CORPORATION, a Delaware
corporation,

Cross-Defendant.

Case No.4:07-cv-05715 WDB

**DECLARATION OF LESLIE MORGAN
IN SUPPORT OF MOTION FOR
SUMMARY JUDGMENT OR, IN THE
ALTERNATIVE, SUMMARY
ADJUDICATION BY McKESSON
CORPORATION**

Complaint Filed: November 9, 2007
Cross-Complaint Filed: December 17, 2007

Motion Date: August 6, 2008
Time: 1:30 p.m.
Place: Ctrm 4
1301 Clay St., 3d Floor
Oakland, CA

1 I, LESLIE MORGAN, declare that I have personal knowledge of the following facts and, if
2 called upon to do so, I could and would testify competently thereto:

3 1. I am employed by McKESSON CORPORATION (“McKesson”). At all times
4 relevant to the events described below, my title was Senior Manager, Contract Compliance.

5 2. In my capacity as Senior Manager, Contract Compliance, I am intimately familiar
6 with the books and records of McKesson (the “Books and Records”), essentially all of which are
7 electronic, into which data is recorded in the ordinary course of McKesson’s business by persons
8 with personal knowledge of the data being recorded. All entries of data into the data bases and
9 other systems included in the Books and Records of McKesson are made at or about the time that
10 events occur that affect the contractual relationships between McKesson and its customers. Among
11 such Books and Records that are kept in the ordinary course of McKesson’s business are books and
12 records relating to the contractual relationship between McKesson on the one hand and
13 FAMILYMEDS GROUP, INC., f/k/a Drugmax, Inc., a Connecticut corporation (“FM Group”) on
14 the other (the “Familymeds Books and Records”).

15 3. Also in the course of my employment with McKesson, I have become intimately
16 familiar with the electronic ordering systems and billing systems that are put into place to enhance
17 our ability to give prompt and effective service to our customers. McKesson is one of the largest
18 distributors in the world of pharmaceutical products and sundry items often sold in pharmacies and
19 drug stores. On a daily basis, McKesson distributes one-third of the medicines used in North
20 America. This necessarily requires McKesson to rely on computer systems and automated systems
21 to facilitate ordering and paying for the products we distribute. These computer systems and
22 automated systems are part of the Books and Records of McKesson.

23 **The “SMO System”.**

24 4. One of the systems that McKesson uses and that is part of the Books and Records of
25 McKesson is the front-end ordering and account management system known as the “Supply
26 Management Online” system or “SMO System.” This system is designed as a convenience for
27 customers and is a powerful tool that allows customers to manage their orders and their payment
28 obligations on a 24/7 basis, all through the Internet.

Billing Statements

9. In its contract with McKesson, FM Group agreed that it would pay the amount shown on each invoice within seven days after the invoice date. At the conclusion of every calendar month, a "Statement" is generated by the SAP System and was typically sent electronically to FM Group as a courtesy, and a copy is posted on the SMO System. Each such Statement lists as of the date the Statement is generated the amounts outstanding on an invoice-by-invoice basis, it identifies any past due amounts, it lists applicable service charges, it indicates the late charge that will be owed if the statement is not timely paid, it lists each "add-bill" item, and it lists all applicable credits, including for returned items. Each of the adjustments reflected on the Statement is explained below:

a. Service Charges, Late Charges and Loss of Timely Payment Discount: Under McKesson's contract with FM Group, the parties agreed that if invoices were not paid timely, FM Group would lose the discount given to FM Group for timely payment and would also incur a "Service Charge" as follows:

Any payments made after the due date indicated herein shall result in a two percent (2%) (or the maximum amount permissible under applicable law, if lower) increase in the purchase price of the Merchandise. A one percent (1%) service charge (or the maximum amount permissible under applicable law, if lower) will be imposed semi-monthly on all balances delinquent more than fifteen (15) days.

b. Add-Bills: Items classified as "add-bills" are charges that McKesson adds to a customer's account due to chargeback discrepancies. Such discrepancies arise when a customer pays a contract price for an item and it turns out the customer was not eligible for that contract price or in circumstances where the price loaded into McKesson's data base was too low. Contract prices paid by a customer are negotiated between the customer and the manufacturer or other supplier of the particular pharmaceutical. McKesson is not responsible for negotiating that contract price between the customer and the manufacturer/supplier. An add-bill requires McKesson's customer to pay the difference between the contract price it negotiated with the manufacturer/supplier and the lower price that was erroneously charged on the relevant invoice.

1 c. Credits. These items consist of reductions to the amounts owed by FM Group to
2 McKesson usually based on returns.

3 10. A Statement for FM Group as of May 30, 2008 is attached to the “Compendium of
4 Exhibits” filed and served herewith (the “Exhibit Compendium”) as **Exhibit E**. FM Group also
5 has a copy of that Statement. The aggregate amount owing to McKesson as reflected on the May
6 30 Statement is \$814,419.44. That figure does not include additional amounts owing by FM group
7 to McKesson on account of various discounts taken by FM Group for which FM Group did not
8 qualify.

9 11. As part of my audit role for McKesson, I caused several invoices sent to FM Group
10 containing more than 90 different products to be audited, meaning that I investigated what base-
11 line price was used by the SAP System and how the price that appeared on the invoice was
12 calculated. Of the audited invoices, there was not a single error made in the computation of FM
13 Group’s Cost of Goods.

14 **Course of Dealing with FM Group**

15 12. The business relationship between McKesson and FM Group is governed by that
16 certain “Supply Agreement” (the “Supply Agreement”) signed by McKesson and FM Group,
17 which was dated as of February 2, 2007 and effective as of December 28, 2007. I have read that
18 agreement and am very familiar with its contents.

19 13. The Supply Agreement permitted FM Group to purchase Merchandise from
20 McKesson for a price defined in the Supply Agreement as the “Cost of Goods.”

21 14. FM Group’s “Cost of Goods” for any particular piece of Merchandise was
22 determined by a formula set forth in the Supply Agreement. That formula relied in each case on a
23 base-line price for the particular product, which was either the “Wholesale Acquisition Cost”
24 (“WAC”), contract pricing, or one of two special pricing models. All such reference prices are
25 entered into McKesson’s data base and on the SAP System in the ordinary course of McKesson’s
26 business at or about the time there is any change in such reference prices.

1 15. The vast majority of the pricing relevant to FM Group was based on either contract
2 pricing or WAC. “Contract pricing” is the price FM Group has itself negotiated the price with the
3 vendor or the manufacturer of a particular item.

4 16. For goods based on “WAC prices”, McKesson refers to the published wholesale
5 acquisition cost posted by the applicable vendor.

6 17. Certain products purchased by FM Group were based on special pricing called
7 “National Specialty Pricing” and “Net-Billed” pricing. The National Specialty Priced products
8 included caps and vials—that is, the containers into which pharmaceutical products are dispensed.
9 The National Specialty price for these caps and vials was WAC.

10 18. “Net-billed” pricing items include slow moving items might have special prices as
11 either an incentive to customers to buy the product, or in some cases, as a disincentive to customers
12 to ask McKesson to stock the particular product.

13 19. Since the effective date of the Supply Agreement, FM Group has ordered and
14 received delivery of goods from McKesson aggregating nearly \$60,000,000.

15 20. FM Group and its constituent pharmacies submitted orders to McKesson on almost
16 a daily basis utilizing the SMO System. Once invoices were generated by the SAP System as
17 described above, they would be transmitted to the SMO System where they could be readily
18 accessed by FM Group 24 hours a day, seven days a week.

19 **Audit of Outstanding Invoices**

20 21. To verify the accuracy of McKesson’s outstanding invoices, I randomly selected
21 three representative invoices to “audit” for pricing errors. Those three invoices reflected orders
22 made on January 29, 2007, March 23, 2007, and July 13, 2007. Those invoices covered 91 line
23 items of products. True and correct copies of those invoices (the “Sample Invoices”) are attached
24 to the Exhibit Compendium as composite **Exhibit F**. The pricing on the sample Invoices has been
25 redacted as it is available to FM Group but is otherwise confidential.

22. I reviewed each of the invoices attached to the Exhibit Compendium as Exhibit F and investigated whether the correct base-line price as described above, was used and whether the correct algorithm was used to calculate the price reflected on the invoice. Each of the invoices I tested contained all four types of base-line prices as described above: contract, WAC and the two types of special pricing. After checking each of the base-line prices, I determined that none of the invoices I investigated had any errors.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed this 4th day of June, 2008 at Norman, Oklahoma

Leslie Morgan
LESLIE MORGAN